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October 16, 2003

VIA HAND DELIVERY

William Foster
Chief, Regulations and Procedures Division
Alcohol & Tobacco Tax & Trade Bureau
ATTN: Notice Number 4
Post Office Box 50221
Washington, D.C. 20091-0221

Re: Notice Number 4: Flavored Malt Beverages and Related Proposals
Dear Mr. Foster:

As Chief Executive Officer of Carolina Beer and Beverage Company, L.L.C. ("CBCo."), I submit the following comments in opposition to Alcohol & Tobacco Tax & Trade Bureau ("TTB") Notice Number 4 (''Notice No. 4''), which proposes to limit the amount of alcohol contributed by flavors and other ingredients containing alcohol to beers and/or malt beverages at or below 6% alcohol by volume ("ABV") to 0.5% of the product's total alcohol content ("0.5% standard").'

Located in Mooresville, North Carolina, CBCo. is a small brewery with a production capacity of approximately 75,000 Bbls. per annum. Since its founding in 1997, CBCo. has

- achieved market success through the production of its own line of beer products, such as Carolina Blonde and Charleston Ales, as well as a variety of flavored malt beverages ("FMBs") for other companies, including Mark Anthony Brands, Inc. and Margarita Ice. While some small breweries claim that the 0.5% standard would not harm America s small brewers, such brewers have never produced an FMB product and have no intention of competing in the FMB category in the future. As these small brewers have no stake in the outcome of this proposed rulemaking, their claims should not be considered as authoritative on these matters. In reality the adoption of the 0.5% standard would have a profound adverse impact on CBCo. and similar small brewers. As a producer of both traditional beers and FMBs, CBCo. strongly urges TTB to reject the 0.5% standard proposed in Notice No. 4 for the reasons stated below, and in the alternative, to adopt a

`See 68 Fed. Reg. 14,291 (Mar. 24, 2003). See also 68 Fed. Reg. 32,698 (June 2, 2003) (extending the deadline for
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submitting comments to October 21, 2003).

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<< 0042873A >>

William Foster
P' October 16, 2003
Page 2

more reasonable majority standard that would require at least 50% of the alcohol in a beer or malt beverage to be derived from fermentation of the product's base.

CBCo. currently derives 70% of its revenues from FMBs and 30% from traditional beer products. Our company has invested significant amounts of capital and resources in order to produce FMBs that comply with long-standing federal policies permitting the liberal use of flavors in beer and malt beverage products. These investments have enabled our brewery to increase its overall product output and effectively compete in all malt beverage markets. If TTB adopts the 0.5% standard, however, it is unlikely that CBCo. would be able to maintain its competitiveness in the FMB industry as we lack the financial resources necessary to acquire the additional fermentation equipment and other technology such a standard would require. Furthermore, we at CBCo. are very concerned that reductions in FMB production could threaten the company's ability to maintain profitability or even stay in business.

From a business perspective, the 0.5% standard effectively protects the interests of certain malt beverage manufacturers at the expense of their competitors. First, the 0.5% standard has been endorsed by mega-brewers that have significant investments in traditional-styled beer and malt beverage products, as well as economies of scale and financial resources that simply dwarf those of smaller competitors like CBCo. Further, some small brewers that produce only traditional-styled beers and malt beverages assert that the existing rules for FMBs create an unlevel playing field between FMBs and their products. In general, however, FMBs are not in direct competition with the beers and malt beverages that these small brewers produce as consumers who desire a full-bodied, micro-brewed ale rarely look to a fruity tasting FMB as a product substitute. Further, CBCo. is unaware of any instance in which small brewers have shown that FMBs place any downward price pressure on their malt beverage products. To the contrary, FMB products are more expensive to make than traditional beers, and thus, are sold at a premium price. Should TTB adopt the 0.5% standard, the price for FMBs will escalate even further.

Arguments urging TTB to adopt the 0.5% standard in order to protect the "integrity of beer" serve as thin guises for their proponents' interest in protecting their own products from the effects of market competition, whether real or imagined. Through the interplay of freedom of choice, ingenuity, and competition, the American marketplace determines which products enjoy strong market share and which do not. Today, consumers are making their choice and paying a premium to enjoy the refreshing, non-traditional beer taste of FMBs. Rather than allow consumers to dictate the course of market competition, the 0.5% standard threatens to concentrate FMB production in the hands of a few large brewers, or more tragically, to eliminate FMBs as a viable product category altogether.

From a legal perspective, while Notice No. 4 specifically states that a majority standard for the source of alcohol in FMBs is permissible under federal law, it instead proposes the much more restrictive 0.5% standard. The preamble notes that historically, the U.S. Department of Treasury and TTB's predecessor agency, the Bureau of Alcohol, Tobacco and Firearms ("ATE"), have relied on the 0.5% standard as the dividing line between taxable and non-taxable alcohol beverages,

<< 0042873B >>

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W
William Foster
October 16, 2003
Page 3

including beer 2. Yet, Notice No. 4 fails to explain why this taxation standard dictates the adoption of a similar standard for the alcohol composition of FMBs. Furthermore, proposing a 0.5% standard for FMBs appears arbitrary when compared to ATF and TTB's long-standing compositional rules for a range of alcohol beverages, for example:

1. A product can qualify as a "malt beverage" if as little as 25% of the fermentable material in a beverage product is derived from malted barley;³
2. Wine containing a minimum of 51% of any Vitis labrusca grape variety can bear that varietal grape designation on its label;⁴ and
3. Distilled spirits products can contain up to 50% wine on a proof gallon basis.⁵

Notice No. 4 also fails to cite any sound, objective evidence demonstrating that the 0.5% standard must be adopted instead of the less restrictive majority standard. As the primary reason in support of the 0.5% standard, Notice No. 4 states that it is inherently misleading to label a beverage that derives most of its alcohol content from flavors and other ingredients containing alcohol as a malt beverage because consumers would expect a product so labeled to derive a ⁶ significant portion of its alcohol content from fermentation. Yet, Notice No. 4 presents no evidence to support this claim of consumer confusion. Rather, from CBCo.'s experience in the marketplace, consumers rarely are concerned with the source of alcohol in an FMB, and instead focus on the product's taste and price when making a purchase decision. Notice No. 4 also cites unspecified state concerns regarding the classification of FMBs as justification for the 0.5% standard. As under federal law, many state laws are silent on the use of flavors in beer or malt beverages.⁷ Once again, Notice No. 4 fails to articulate any legal or public policy grounds that necessitates the selection of the 0.5% standard rather than the majority standard in order to respond to state concerns.

In conclusion, we at CBCo. have worked hard to build a successful small brewery, and that success is in large part due to TTB's long-standing policies regarding the manufacture of FMBs. As stated above, we believe that federal law and basic principles of fairness support the adoption of a majority standard, rather than the 0.5% standard. CBCo. therefore strongly urges TTB to reject the 0.5% standard and to adopt a majority standard that will allow small breweries like ours to remain competitive and generate much needed jobs in our communities.

² 26 U.S.C. ~ 5052.

³ The Beverage Alcohol Manual, Malt Beverages (Vol. 3), ATF Pub. 5130.3 (7-2001) at 4-2.

⁴ 27 C.F.R. § 4.23(c).

⁵ 27 C.F.R. § 5.11.

<< 0042873C >>

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William Foster
16, 2003
Page 4

Sincerely,

J. Michael Smith, CEO
Carolina Beer & Beverage, L.L.C.